

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:CORP:B05

PLR-147021-06

Date:

December 20, 2006

Legend

Distributing =

State X =

Business 1 =

Date1 =

Date 2 =

Shareholder A1 =

Shareholder A2 =

Shareholder A3 =

Shareholder A4 =

Shareholder B1 =

Shareholder B2 =

Shareholder B3 =

Shareholder B4 =

Dear :

This letter responds to your September 22, 2006 request for rulings regarding certain federal income tax consequences of a proposed transaction. The information submitted in that request and in later correspondences dated October 6, 2006, October 23, 2006, November 8, 2006, and November 21, 2006, is summarized below.

Facts

Distributing is a State X corporation that directly conducts Business 1. Distributing was incorporated on Date 1 as a subchapter C corporation but converted to a subchapter S corporation effective Date 2. It is a cash method taxpayer filing its returns on a calendar year. Financial information has been received indicating that Distributing has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years. Distributing has a single class of voting common stock.

The family of Shareholder A owns approximately one-half of Taxpayer's stock. Specifically, Shareholder A1, Shareholder A2, Shareholder A3 and Shareholder A4 hold %, %, % and %, respectively, of Distributing's stock. The family of Shareholder B owns the remaining one-half of Taxpayer's stock. Specifically, Shareholder B1, as Trustee of the Living Trust of Shareholder B1, Shareholder B2, as Trustee of the Living Trust of Shareholder B2, Shareholder B3, and Shareholder B4 hold %, %, % and %, respectively, of Distributing's stock.

To resolve management, systemic, and other problems that have arisen because of irreconcilable differences between the two families, the shareholders have proposed to separate Distributing proportionally in accordance with the two families' relative share interests.

To effectuate the proposed transaction, the shareholders will cause Distributing to form a new corporation ("Controlled") and contribute to Controlled certain of its residential and commercial properties and cash, solely in exchange for the assumption of related liabilities and % of the stock of Controlled. Controlled will be a cash method taxpayer formed under the laws of State X. Immediately after the transfer of assets by Distributing to Controlled, Distributing will distribute all of the stock of

Controlled to the family of Shareholder A in exchange for all of the stock of Distributing owned by the family of Shareholder A. Controlled will elect to be taxed as a subchapter S corporation on the first available date after the distribution.

Representations

The taxpayers have made the following representations in connection with the transaction described above:

- (a) Distributing, Controlled and each of the shareholders will each pay his, her, or its own expenses incurred in connection with the proposed transaction.
- (b) No part of the Controlled stock to be distributed by the Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
- (c) The five years of financial information submitted on behalf of Distributing is representative of Distributing's present operation, and with regard to Distributing, there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) Following the transaction, Distributing and Controlled will each continue, independently and with its separate employees, the active conduct of its share of all the integrated activities of the business conducted by Distributing prior to consummation of the transaction. There is no planned or intended substantial reduction in business activity for any active business.
- (e) The distribution of the stock, or stock and securities, of Controlled is carried out for the following corporate business purposes: (a) to resolve shareholder disputes concerning the operation and management of the business; (b) to resolve shareholder disputes concerning the strategic direction of the business; and (c) to resolve shareholder disputes concerning the fundamental business matters. The distribution of the stock, or stock and securities, of Controlled is motivated, in whole or substantial part, by one or more of these corporate business purposes.
- (f) The transaction is not used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both.

- (g) There is no plan or intention to liquidate either Distributing or Controlled, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation after the transaction, except in the ordinary course of business.
- (h) The total adjusted bases and the fair market value of the assets transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities assumed (within the meaning of § 357(d)) by Controlled plus any liabilities to which the transferred assets are subject.
- (i) The liabilities assumed (within the meaning of § 357(d)) in the transaction and the liabilities to which the transferred assets are subject were incurred in the ordinary course of business and are associated with the assets being transferred.
- (j) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (k) No investment credit has been (or will be) claimed with respect to the transferred property.
- (l) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of Controlled stock.
- (m) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (n) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (o) The distribution is not part of a plan or series of related transactions (within the meaning of § 1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50 percent or greater interest (within the meaning of § 355(d)(4)) in Distributing or Controlled (including any predecessor or successor of any such corporation).
- (p) For purposes of § 355(d), immediately after the distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50 percent or more of the value of the total combined shares of all classes of Distributing stock, that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-

year period (determined after applying § 355(d)(6)) ending on the distribution date.

- (q) For purposes of § 355(d), immediately after the distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock, or 50 percent or more of the value of the total combined shares of all classes of Controlled stock, that was either (i) acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the distribution date, or (ii) attributable to distributions on Distributing stock that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the distribution date.
- (r) The total fair market value of the assets transferred in the proposed transaction will equal or exceed the aggregate adjusted bases of those assets.
- (s) The fair market value of the Controlled stock to be received by Distributing shareholders will be approximately equal to the fair market value of the Distributing stock surrendered by such shareholders in the exchange.
- (t) Neither Distributing nor Controlled will be a disqualified investment corporation (within the meaning of § 355(g)(2)).

Rulings

Based solely on the information submitted and on the representations set forth above, we rule as follows with respect to the proposed transaction:

- (1) The transfer by Distributing to Controlled of part of its assets in exchange for all of the Controlled stock and assumption of liabilities followed by the distribution of all the Controlled stock to Controlled Shareholders in exchange for all of Controlled Shareholders' Distributing stock will constitute a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled will each be "a party to a reorganization" within the meaning of § 368(b).
- (2) Distributing will recognize no gain or loss upon the transfer of assets to Controlled in exchange for Controlled stock and the assumption of liabilities (§§ 361(a) & 357(a)).
- (3) Controlled will recognize no gain or loss on the receipt of assets in exchange for Controlled stock (§ 1032(a)).

- (4) Controlled's basis in each asset received from Distributing will equal the basis of such asset in the hands of Distributing immediately prior to the transaction (§ 362(b)).
- (5) Controlled's holding period of each asset received from Distributing will include the period during which Distributing held such asset (§ 1223(2)).
- (6) The Controlled Shareholders will recognize no gain or loss (and no amount will otherwise be included in the income of the Controlled Shareholders) upon receipt of the Controlled stock in exchange for all of Controlled Shareholders' Distributing stock (§ 355(a)).
- (7) Distributing will recognize no gain or loss on the distribution of the Controlled stock to Controlled Shareholders (§ 361(c)).
- (8) The aggregate basis of the Controlled stock in the hands of the Controlled Shareholders will equal the aggregate basis of the Distributing stock surrendered in the exchange (§ 358(a)).
- (9) Controlled Shareholders' holding period of the Controlled stock received in the distribution will include the holding period of the Distributing stock surrendered in the exchange, provided that the Distributing stock is held as a capital asset on the date of the exchange (§ 1223(1)).
- (10) Distributing's earnings and profits will be allocated between Distributing and Controlled in accordance with § 312(h) and § 1.312-10(a).
- (11) The accumulated adjustments account of Distributing will be allocated between Distributing and Controlled in a manner similar to the manner in which the earnings and profits of distributing will be allocated under §312(h) (see § 1.312-10(a) and § 1.1368-2(d)(3)).
- (12) Distributing's momentary ownership of the stock of Controlled, as part of the reorganization under § 368(a)(1)(D), will not cause Controlled to have an ineligible shareholder for any portion of its first taxable year under §1361 (b)(1)(B). If Controlled otherwise meets the requirements of a small business corporation under § 1361, Controlled will be eligible to elect to be a subchapter S corporation under § 1362 (a) for its first taxable year.
- (13) Controlled will be subject to § 1374 with respect to any asset transferred from Distributing to Controlled to the same extent Distributing would have been subject to § 1374 with respect to such asset had Distributing made an election to be treated as a subchapter S corporation. For purposes of

§1374, Controlled's recognition period will be reduced by the portion of D's recognition period that expires prior to Distributing's transfer of these assets to Controlled (§ 1374 (d)(8) & Ann. 86-128, 1986-51 I.R.B. 22).

Caveats

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, no opinion is expressed regarding: (i) whether the distribution satisfies the business purpose requirement of § 1.355-2(b); (ii) whether the transaction is used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both; and (iii) whether the distribution and an acquisition or acquisitions are part of a plan (or series of related transactions) under §355(e)(2)(A)(ii). Further, no opinion is expressed concerning whether Distributing's S election is valid; whether Controlled is otherwise eligible to be taxed as an S corporation; and whether Controlled's election to be an S corporation will be valid under §1362(a).

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Debra Carlisle

Debra Carlisle
Chief, Branch 5
Office of Associate Chief Counsel
(Corporate)